No. 80544-0

MADSEN, J. (dissenting)—The court must decide the meaning of the words "derived from interest" in RCW 82.04.4292. Unfortunately, the majority determines the meaning of these words without regard to the context in which they are used and the related statutes that give them meaning. The majority thus disregards the numerous cases in which this court has explained how to determine the plain meaning of a statutory term. In addition, the majority says that it is not essential to determine why the money is received, but it is not only essential, it is the *first step* in applying this taxing scheme. Moreover, the majority fails to apply the principle that deduction and exemption tax statutes are to be narrowly construed. To top it all off, the majority also misstates the facts.

When the proper analysis is applied, it is apparent that the deduction in RCW 82.04.4292 applies only to income that is received by the taxpayer as interest income. It does not apply to fees received by HomeStreet, Inc., in exchange for servicing mortgages that have been transferred to third parties. Accordingly, HomeStreet is not entitled to the

deduction.

Analysis

The goal when determining the meaning of statutory language is to understand what the legislature intended and then carry out that intent. *Densley v. Dep't of Retirement Sys.*, 162 Wn.2d 210, 231, 173 P.3d 885 (2007). The starting point is the plain language and ordinary meaning of the language used, because if the meaning of the language is plain, then it must be given effect as an expression of the legislature's intent. *Id*.

But this does not mean that the language is examined in a vacuum. Rather, as part of the inquiry into whether there is a plain language meaning to be ascertained, the statutory context in which the particular language appears must be considered, as well as related statutes. The majority fails to engage in this analysis, instead applying a "plain meaning" approach that this court *explicitly* abandoned in favor of an approach that better reflects legislative intent.

In *Department of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 43 P.3d 4 (2002), we recognized that there were two existing lines of cases from this court that described the "plain meaning rule" in quite different ways. Under the first line of cases, a court would endeavor to determine plain meaning solely from the wording of the statute itself. *Id*. at 10. If the language was found to be unclear or ambiguous, then, as a part of the inquiry into legislative intent and to resolve the ambiguity, the court would consider the statutory scheme as a whole and related statutes. *Id*.

However, in another long line of

cases, this court said that to determine plain meaning a court should examine the statute in which the language in question appears "as well as related statutes or other provisions of the same act in which the provision is found." *Id*. "Under this second approach, the plain meaning is still derived from what the Legislature has said in its enactments, but that meaning is discerned from *all that the Legislature has said in the statute and related states which disclose legislative intent about the provision in question*." *Id*. at 11 (emphasis added). "[I]f, after this inquiry, the statute remains susceptible to more than one reasonable meaning, the statute is ambiguous and it is appropriate to resort to aids to construction, including legislative history." *Id*. at 12. We deliberately chose the second line of cases as representing "the better approach because it is more likely to carry out legislative intent." *Id*.

We have reiterated this test of plain meaning in numerous cases. *E.g.*, *Densley*, 162 Wn.2d at 231 ¶ 47; *Cornhusker Cas. Ins. Co. v. Kachman*, 165 Wn.2d 404, 409, 198 P.3d 505 (2008); *Tesoro Ref. & Mktg. Co. v. State, Dep't of Revenue*, 164 Wn.2d 310, 319 ¶ 12, 190 P.3d (2008) (plurality); *Christensen v. Ellsworth*, 162 Wn.2d 365, 373 ¶ 12, 173 P.3d 228 (2007); *City of Olympia v. Drebick*, 156 Wn.2d 289, 295 ¶ 6, 126 P.3d 802 (2006); *Advanced Silicon Materials, LLC v. Grant County*, 156 Wn.2d 84, 89 ¶ 10, 124 P.3d 294 (2005); *Sheehan v. Cent. Puget Sound Reg'l Transit Auth.*, 155 Wn.2d 790, 797 ¶ 15, 802 ¶ 24, 123 P.3d 88 (2005); *State v. Jacobs*, 154 Wn.2d 596, 600 ¶ 7, 115 P.3d 281 (2005); *Dep't of Labor & Indus. v. Gongyin*, 154 Wn.2d 38, 45 ¶ 9, 109 P.3d 816 (2005); *State ex rel. Citizens Against Tolls v. Murphy*, 151 Wn.2d 226, 242, 88 P.3d 375 (2004); *State v. J.P.*, 149 Wn.2d 444,

450, 69 P.3d 318 (2003); *City of Seattle v. Allison*, 148 Wn.2d 75, 81, 59 P.3d 85 (2002); *see also*, *e.g.*, *State v. Krall*, 125 Wn.2d 146, 148, 881 P.2d 1040 (1994) (the meaning of words in a statute is determined from "'all the terms and provisions of the act in relation to the subject of the legislation, the nature of the act, the general object to be accomplished and consequences that would result from construing the particular statute in one way or another'" (quoting *State v. Huntzinger*, 92 Wn.2d 128, 133, 594 P.2d 917 (1979)); *Burns v. City of Seattle*, 161 Wn.2d 129, 146, 164 P.3d 475 (2007).

Nevertheless, the majority declines to follow our precedent and instead reverts to the formulation of the plain meaning rule that we deliberately discarded on the ground that it is not the best method for determining and applying legislative intent. I believe we should adhere to our precedent. When we are faced with a complex statutory scheme, as we are here, it is imperative that we use the best tools at our disposal.

When RCW 82.04.4292 is examined in the context of the entire statutory scheme and related statutes, its meaning is apparent. The statute is not ambiguous, but its plain meaning is not what the majority says.

We begin with the broad rule under RCW 82.04.290(2) that financial businesses must pay a business and occupation tax (B&O tax) on the "gross income of the business" at a rate of 1.5 percent. RCW 82.04.4292, the statute at issue, then provides for a deduction from income for purposes of B&O tax. It provides in relevant part that "amounts derived from interest received on investments or loans primarily secured by first mortgages" may be "deducted from the measure of tax" by taxpayers in financial businesses. RCW 82.04.4292. The

"measure of tax" referred to in RCW 82.04.4292 is thus the "gross income of the business." The "gross income of the business" is a statutorily defined term, and in the definition of the term the legislature identified and distinguished many *types* of income that a financial business might obtain. The "gross income of the business" means:

> The value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, *compensation for the rendition of services*, gains realized from trading in stocks, bonds, or other evidence of indebtedness, *interest*, discount, rents, royalties, *fees*, commissions, dividends, and other emoluments however designated.

RCW 82.04.080 (emphasis added).

Thus, under the B&O tax scheme pertaining to financial businesses, "compensation for rendition of services," "fees" and "interest" are all defined types of potential gross income of a financial business, and each is distinguishable from the others. By defining what constitutes the gross income of a financial business, which includes all of these forms of income, and then providing in RCW 82.04.4292 that "amounts derived from interest" may be deducted from the measure of tax, the legislature set up a general rule of taxable income and a deduction from taxable income in the case of "amounts derived from interest."

The definition of "gross income of the business" provides other information that is important to understanding the deduction in RCW 82.04.4292. It begins with (1) "[t]he value proceeding or accruing" (2) "by reason of the transaction of the business engaged." The first of these phrases is also a defined term, and it is a critical definition for understanding the taxing scheme. RCW 82.04.090 states that "'[v]alue proceeding or accruing' means the consideration, whether

money, credit, rights, or other property expressed in terms of money, actually received or accrued." Among other things, this means that the types of gross income listed in RCW 82.04.080 are identified by the character of the consideration *as it is received by or accrued to* the taxpayer.[1] The types of income are *not* identified by the character of the consideration as it is *paid* by the other party (or parties) to the business transaction. Rather, the character of the income is determined by how it *is received by the taxpayer*. This concept is elementary; we look to the income in the hands of the taxpayer to determine its character and whether it is subject to taxation.

The majority is thus absolutely incorrect when it states that "it is not essential to determine why the money is received." Majority at 10. Notably, the majority's error occurs because it fails to consider all the statutes that are relevant to the meaning of RCW 82.04.4292.

The second phrase means that the consideration that is subject to tax is received by the taxpayer (or accrues to the taxpayer) by reason of the business transaction in which the taxpayer engaged.

With these statutes in mind, it is obvious that the deduction in RCW 82.04.4292 does not apply to the amounts that HomeStreet claims are "amounts derived from interest." HomeStreet originates first mortgage loans but then assigns them to third parties. Pursuant to contracts entered into with the third party mortgage assignees,

[1] Taxpayers generally employ either a cash or accrual basis of accounting, and RCW 82.04.090 provides that the term "value proceeding or accruing" is to apply, "in each case, on a cash receipts or accrual basis according to which" of these methods of accounting is used.

HomeStreet keeps the rights to service the mortgages. Servicing the mortgages involves a number of responsibilities, including the responsibility to collect amounts due from the borrowers and remit them to the mortgage assignees. The contracts between HomeStreet and the third party mortgage assignees provide that, in exchange for these services, HomeStreet is paid for these services (servicing the mortgages) from the amount of interest paid and generally calculated as a percentage of the outstanding principle balance.

The amounts in dispute are thus servicing fees paid to HomeStreet. The majority asserts, however, that it is incorrect to say that the revenue that HomeStreet receives consists of servicing fees, because the borrowers still borrowed the money from HomeStreet and HomeStreet still collects the payments, including interest. Majority at 8. This is a misstatement of what occurs. The loans themselves have been sold to third parties, with HomeStreet having the contractual right to service the mortgages, a service for which it is paid. HomeStreet collects the payments because that is one of its obligations in servicing the mortgages. It does not collect them as the lender. It remits the payments to the third party mortgage assignees, after retaining the contractual fees that it is due for servicing the mortgages.[2]

[2] The majority is also mistaken about which transactions are addressed in this dissent. Majority at 3. The service-released loans are irrelevant for present purposes. Instead, the loans at issue are those that have been assigned to third parties, with HomeStreet retaining, by contract with those third parties, a portion of the amount the borrower pays as a fee for the services that HomeStreet provides to that third party assignee. As the Court of Appeals correctly put it:

> When HomeStreet or any mortgage lender originates a mortgage loan, it creates a relationship between itself and the borrower by allowing the borrower to use its money in return for interest on its capital. This relationship falls squarely

HomeStreet contends that its servicing fees are deductible under RCW 82.04.4292 as "amounts derived from interest." But these servicing fees are not received by HomeStreet as "amounts derived from interest," as explained below.

A deduction from the income that is otherwise subject to B&O tax requires that the income first be identified. Since the business in which HomeStreet is engaged is financial business, RCW 82.04.080 is the statute that defines gross income. As explained, this statute distinguishes between consideration received in the form of *compensation for rendition of services*, *interest*, and *fees*. The legislature plainly intended that "compensation for rendition of services" and "fees" are different forms of gross income from "interest" and must be analyzed separately. In addition, under this statute and RCW 82.04.090, the character of the income is determined as it is received by (or accrues to) the taxpayer and the income is received by (or accrues to) the taxpayer by reason of the business transaction.

Under these statutes, the income that would be taxed absent the deduction, if it were to apply, consists of the fees that HomeStreet is paid for servicing the mortgages it has assigned to third parties. That is, the income to HomeStreet as it is received (or accrued) consists of fees paid to it for mortgage servicing. HomeStreet does not receive

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> within the statutory tax deduction. But when HomeStreet sells the loan on the secondary market, it recovers the capital it invested and the borrower is no longer paying HomeStreet for using its money. And, *in servicing retained sales, HomeStreet retains only the right to provide loan servicing for the purchaser of the loan and to be compensated for those services*.

*HomeStreet, Inc. v. Dep't of Revenue*, 139 Wn. App. 827, 843, 162 P.3d 458 (2007) (emphasis added). It is the compensation for those services that is actually at issue here.

interest income from the payments made by the borrowers. In addition, the business transaction from which HomeStreet obtains the amounts in dispute is the contract between HomeStreet and the third party—*it is not the lending of money to the borrower*. Thus, the particular "gross income from business" at issue here consists of the *fees* paid to HomeStreet for its servicing the mortgages.

The deduction in RCW 82.04.4292 is for "amounts derived from interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties." The legislature's differentiation between types of income that constitutes "gross income" shows that *if* it meant the deduction in RCW 82.04.4292 to apply to other types of gross income than interest, it would have explicitly said so.

This conclusion is reinforced by other statutes authorizing deductions from B&O taxation. For example, RCW 82.04.4282 allows a deduction for "[a]mounts derived from bona fide (1) initiation fees, (2) dues, (3) contributions, (4) donations, (5) tuition fees, (6) charges made . . . for operation of privately owned kindergartens, and (8) endowment funds." This is a detailed, precise list of income that may be deducted from income for B&O tax purposes. The legislature clearly listed the specific items that may be deducted, that is, the deduction is in the amount of money from these specific types of income when received by the business.

And in fact, this is what this court held when it was faced with this particular statute[3] and a claim involving payments made to the Red Cedar Shingle Bureau, a nonprofit corporation in the business of

promoting trade and in particular working to prevent antishingle legislation and discriminatory insurance differentials. *Red Cedar Shingle Bureau v. State*, 62 Wn.2d 341, 382 P.2d 503 (1963). Under its bylaws, members were charged "'in consideration of the services rendered and to be rendered by the corporation" an amount based on the number and type of shingles they manufactured. *Id*. at 346. The court rejected the corporation's claim that it was entitled to deduct these amounts paid as "dues" or "contributions," stating that "'dues,' given its ordinary everyday meaning does not connote payments" like those at issue made "to 'trade associations'" for the kind of services rendered.[4] *Id*. at 346-47 (emphasis omitted).

By comparison to RCW 82.04.4286 (and analogy to *Red Cedar Shingle Bureau*), it is apparent that by listing only "interest" as the source of income that may be deducted, the legislature meant in RCW 82.04.4292 to limit the deduction to income received as "interest."

Other statutes also reinforce this conclusion and help explain the legislature's use of the words "amounts derived from" in RCW 82.04.4292 because, unlike a deduction from income based on its character *as income* (as in this case), they provide for nontaxability based on the character of amounts *paid from income*. For example, RCW 82.04.285 requires B&O taxes on gross income from operating games of chance, but

[3] The statute was codified at former RCW 82.04.430(2) (1979), *repealed by* Laws of 1980, ch. 37, § 81.

[4] The court added that if there was any doubt about this conclusion, "and we believe there is none" the Board's argument was untenable "for another reason"—a proviso in the statute. *Red Cedar Shingle Bureau*, 62 Wn.2d at 346-47.

subsection (4) states that "'[g]ross income of the business' does not include the monetary value or actual cost of any prizes that are awarded, amounts paid to players for winning wagers," and so forth. Thus, nontaxability depends on what is paid for.

The distinction is that nontaxability based on what the taxpayer is paying money for is different from nontaxability based on the kind of income received. By using the words "amounts derived from" in connection with interest, the legislature indicated that the deduction it intended is for interest income and not for amounts paid by the taxpayer as interest. Therefore, the words "amounts derived from" are not superfluous—they have meaning—but they do not have the meaning argued for by HomeStreet.

The words "amounts derived from" do not mean the income that may be deducted is of any type at all when received, so long as it was *paid* somewhere along the line as interest. And any such conclusion is counter to the provisions in RCW 82.04.080 (defining gross income) and RCW 82.04.090 (defining "value proceeding or accruing").

Finally, in interpreting RCW 82.04.4292, the majority fails to apply the principle that courts should narrowly construe statutes setting out deductions and exemptions. *O'Leary v. Dep't of Revenue*, 105 Wn.2d 679, 682, 717 P.2d 273 (1986); *Evergreen-Washelli Mem'l Park Co. v. Dep't of Revenue*, 89 Wn.2d 660, 663, 574 P.2d 735 (1978). At a very minimum, the related statutes in chapter 82.04 RCW render the majority's reading of the statute highly questionable. This, at a minimum, should trigger the court's obligation to narrowly construe the statute and hold that it applies by its terms only to interest.

When RCW 82.04.4292 is read in

the context of the B&O taxing scheme as a whole, and in light of related statutes, its plain meaning is that the servicing fees that HomeStreet received for servicing the assigned mortgages are not deductible under the statute. It is also apparent that the statute applies only to interest income received on "investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties." RCW 82.04.4292.

Conclusion

The majority fails to follow settled precedent for determining whether statutory language has a discernable plain meaning. When our precedent is followed, it is clear that RCW 82.04.4292 has a plain meaning, but it is not the meaning accorded the statute by the majority. Rather, the statute pertains only to interest and, more particularly for purposes of this case, it clearly does not apply to fees that are received for servicing mortgages conveyed to third parties.

The fact that the source of the fees is or may have been interest when paid by the borrower is irrelevant, because characterizing income, and therefore deductions of amounts derived from income, for B&O taxing purposes depends on its nature *when received by the taxpayer*. Here, the amounts were received by HomeStreet in the form of fees under the contracts between HomeStreet and the third party mortgage assignees.

I dissent.

AUTHOR:
Justice Barbara A. Madsen

WE CONCUR:

Justice Tom Chambers, result only